STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 99-176

April 29, 1999

S.D. WARREN COMPANY
Petition to Resolve Dispute on Short-Term Energy-Only Sales Agreement with Central Maine Power Company and Request to Waive Filing Fee

ORDER ON PETITION TO RESOLVE DISPUTE

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

In this Order, we deny S.D. Warren Company's (Warren) request that Central Maine Power Company (CMP) be directed to enter a short-term energy-only (STEO) agreement without provisions that subject Warren to curtailment pursuant to new regional market rules.

II. BACKGROUND

On March 17, 1999, Warren filed a petition, pursuant to 35-A M.R.S.A. § 3306, to resolve a dispute with CMP concerning a proposed STEO agreement. Specifically, Warren requests that the Commission: (1) determine that Warren is not required to agree to certain new provisions demanded by CMP that would subject Warren to economic curtailment by ISO-NE of excess energy generated by its cogeneration facility in Westbrook, Maine, and (2) direct CMP to execute the otherwise mutually agreed to STEO agreement without these additional provisions sought by CMP. Warren further requests that the Commission waive the filing fee required by 35-A M.R.S.A. § 3306(6).[1]

Warren owns and operates a pulp and paper manufacturing facility in Westbrook, Maine, and is a qualifying facility (QF) under federal and State law. The mill's generation facility has a capacity of approximately 80 megawatts and can export up to 35 - 45 megawatts of excess energy and capacity above its electrical load. From October 1982 through October 31, 1997, the mill sold all of its electric generation to CMP and purchased all of its electrical load from CMP, pursuant to a 15-year simultaneous purchase and sales agreement. Since the expiration of that agreement, Warren and CMP have entered a series of power purchase agreements for the sale of 30 megawatts of energy and capacity at fixed rates. Prior to the December 31, 1998 expiration of the most recent of these agreements, CMP indicated that it had no continuing need for Warren's generation capacity and the parties thereafter agreed for Warren to sell CMP its excess energy at Commission-established STEO rates. Warren

[1]For good cause, we waive the filing fee as requested by Warren.

has been making sales to CMP at STEO rates since January 1, 1999. The parties' current agreement expires April 30, 1999.

The current dispute between the parties arises from CMP's insistence that any new STEO agreement to purchase energy from Warren after April 30, 1999 must include provisions requiring Warren to operate its facility to comply with ISO-NE operating procedures and market rules, including a requirement that Warren curtail or reduce its deliveries of excess energy if CMP receives such an order from ISO-NE. CMP advised Warren that these provisions were necessary because new market rules developed by NEPOOL no longer treat utility obligations to purchase energy under QF contracts as "must run," and require utilities to curtail such generation in response to direction from ISO-NE. CMP indicated that it could be subject to substantial penalties if it were unable to assure curtailment of its QF facilities under contract in response to an ISO-NE curtailment order. Warren responded to CMP that it would not agree to the new provisions, because subjecting its facility to curtailment by ISO-NE is inconsistent with Warren's rights under Maine's Small Power Production Act (SPPA) and Chapter 360 of the Commission's Rules to sell all of its excess energy to CMP at Commission-established STEO rates, and that curtailment of Warren's facility, whose generation of minimum excess energy is driven by the mill's steam requirements, could threaten the mill's operation.

Prior to and since the filing of Warren's petition, CMP has requested that NEPOOL revise the market rules to recognize a participant's obligation to purchase energy from QFs. NEPOOL adopted such revisions for a 120-day period. However, a participant has appealed the adoption of the revisions to the NEPOOL Executive Committee, making the implementation and timing of the revisions uncertain.

By agreement of the parties, the Examiner adopted a schedule in this case whereby each party filed legal and responsive memoranda.[2] The parties indicated that a factual hearing not be necessary. On April 15, 1999, a technical conference was held by telephone to allow the Commission's Advisory Staff to obtain further information regarding the nature of the dispute. Warren, CMP, and the Public Advocate participated in that conference. Without objection from CMP, Warren filed supplemental comments on April 22, 1999.

III. POSITIONS OF THE PARTIES

A. S.D. Warren

S.D. Warren presents several arguments in support of its view that the Commission should conclude that CMP is not entitled to require that Warren be subject to ISO-NE dispatch orders. First, Warren cites the SPPA, 35-A M.R.S.A. §§ 3301 - 3308, section 9 of the Restructuring Act, P.L. 1997, ch. 316, and Chapter 360 of the Commission's Rules as providing for an absolute obligation for CMP to purchase any and all of Warren's excess energy at Commission-established STEO rates. Warren

[2]The parties agreed to waive an Examiner's Report.

argues that the language in the law and rules is unqualified and does not suggest that CMP may refuse to purchase energy from a QF as a result of developments in NEPOOL or ISO-NE market rules. According to Warren, Maine law essentially treats its excess energy as "must run" for purposes of CMP's purchase obligations.

Further, Warren argues that the Commission should conclude that QFs in Maine cannot be forced to comply with market rules developed among NEPOOL participants, including CMP, where QFs are not NEPOOL participants and have no meaningful opportunity to ensure that such rules are consistent with contractual and legal rights of QFs in Maine. Warren states CMP and other NEPOOL participants are free to collaborate to develop market rules applicable to dealings with one another, but have no authority to agree on rules that violate federal and state law and state regulations governing the rights of QFs to sell available energy. Further, the participant utilities have no right to adopt rules with the intent or the effect of altering or circumventing contracts between themselves and third parties that are not participants.

Warren states that forcing it to curtail its deliveries of excess energy threatens the operations of its mill in Westbrook, because approximately 4 to 15 megawatts of minimum excess generation is automatically produced at the facility as a consequence of meeting the steam requirements of the mill.[3] Warren notes that the problem caused by the developing market rules is not specific to it, but also applies to all of CMP's contractual and statutory obligations to purchase power from QFs and is also likely to be a problem for other NEPOOL participants with QF obligations. For this reason, Warren believes it to be grossly unfair for CMP to impose the new curtailment provisions on a single STEO seller. The problem should be resolved by CMP and other NEPOOL participants by assuring that the market rules respect State law and contractual obligations; the problem should not be dropped on Warren's lap through a provision that threatens one cogenerator's ability to operate its business.

B. Central Maine Power Company

CMP states that, historically, it has been able to treat QFs as "must run" generation that is not subject to dispatch by NEPOOL. Pursuant to Federal Energy Regulatory Commission (FERC) rules, however, NEPOOL has been engaged in a restructuring process to allow for greater competition in the electricity markets. This process has included the establishment of an independent system operator (ISO-NE) and the development and implementation of new market rules. As part of the new structure, the cost-based system of dispatch is replaced with a bid-based "spot market" mechanism for determining dispatch.

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[3]Warren explains that in order to produce the mill's required level of steam and not generate excess energy, the mill would be required to bypass certain volumes of steam from its generators through pressure reduction valves, a process that would waste an extraordinary amount of energy and increase the mill's operating costs. Additionally, bypassing steam from the generators would result in the inability of the mill to heat its process water, adversely affecting the quality of the paper produced at the mill.

CMP explains that under the new market rules, CMP must provide ISO-NE with an energy bid for each generator which acts as CMP's offer to supply energy at a specified cost. Because none of the QFs in Maine is a NEPOOL participant, CMP, as the participant purchasing the QF energy, must submit energy bids for the power. CMP indicates that it intends to "self-schedule" (essentially a bid of $0.00 per kWh) its entitlements from its QF obligations, and that, generally, the "self-schedule" will result in ISO-NE acceptance of the QF energy regardless of the current market price. Self-schedules, however, are subject to being rejected by ISO-NE if the self-scheduled output level would cause a transmission constraint, excess generation problem, or other reliability constraints. Under the market rules, a participant may pay for the right not to be backed down and units that are backed down may be eligible to receive a back down charge based on their energy bids. Thus, in the event of an excess of self-scheduled generation, CMP must either reduce deliveries from QFs or pay back down charges to those units that do back down.

CMP further states that, under the new market structures, generators that prefer not to be backed down during light load situations have the option to, in essence, submit negative bid values. In an hour where self-scheduled facilities have to be backed down, the clearing price would be negative, resulting in payments by those facilities that continued to run. If a QF continues producing energy after being dispatched off-line by ISO-NE, the purchasing participant (in this case CMP) will be responsible for paying the negative market clearing price. In addition, CMP may also be faced with ISO-imposed monetary sanctions as a result of the deliberately ignoring ISO-NE dispatch instructions. CMP states that negative energy bids represent the participant's willingness to pay to avoid reducing the output of a unit. As units are backed down below their operating limits, the energy clearing price becomes negative to reflect the negative bids of the units being backed down. In an excess generation situation, QFs are expected to back down on the same terms as any other generator. CMP states that there is no means to ensure that a QF will be entitled to run at all times, unless a bid of "negative infinity" is submitted. By making a negative bid for a QF unit, CMP would commit itself to paying other NEPOOL participants, through the market settlement process, to allow the QF to run during excess generation situations.

CMP does not dispute Warren's right to sell energy to CMP at STEO rates, but disputes the legal scope of that right. CMP notes that section 9 of the Restructuring Act and Chapter 360 were developed when QFs were treated by NEPOOL as "must run." However, the supervening revisions to the market rules that take away "must run" status from QFs make it impossible, or at least impracticable, for CMP to retain the obligation to purchase all QF energy whenever it is made available.

CMP argues that its statutory obligation to make STEO purchases is not absolute and unequivocal. Chapter 360 has always recognized that there are circumstances in which utilities are not obligated to make QF purchases. CMP cites sections 4(D) and 6 of Chapter 360 that allow for curtailment of purchases under specified circumstances. CMP states that the Commission has authority to establish rules consistent with statutory intent and that the basic concept of "avoided costs" means utilities should pay no more for QF power than if the utility generated the power for itself. CMP characterizes Warren's position as requiring CMP to expose itself to costs (negative energy clearing prices, back down charges and punitive sanctions) beyond the STEO rates. Under these circumstances, CMP argues that impossibility or impracticability principles relieve it from complying with purchase requirements.

Finally, CMP points out that NEPOOL is no longer an association of electric utilities and now includes all market participants. NEPOOL and ISO-NE establish standards and policies for system reliability, market rules, and dispute resolution by mutual consent, and it is the ISO-NE that has final authority and decides what generation must be backed down. CMP responds to Warren's argument that it cannot be subject to rules adopted by NEPOOL by stating that the market rules are filed at FERC and are considered tariffs; therefore, federal preemption, under the filed-rate doctrine, would preclude the Commission from ordering CMP to enter a contract that would cause its non-compliance with market rules that have the effect of federal law.

In response to Warren's argument that the issue presented in this case applies generally to all QFs and, therefore, Warren alone should not be subject to additional dispatch obligations, CMP states that the market rules distinguish between new contracts and existing contracts regarding the applicability of sanctions for failure to comply with ISO-NE dispatch instruction. CMP states that the market rules require new contracts be structured to require the supplier to comply with ISO-NE instructions and the market rules. Thus, CMP is affirmatively required to include such provisions in new contracts.

C. S.D. Warren Supplemental Response

Warren filed a supplemental response, arguing that the filed-rate doctrine does not apply in this case. The doctrine only applies if there is a true conflict between FERC approved tariffs and State law or contracts and, according to Warren, no such conflict exists. Warren states that there is no federal/state conflict, because CMP can comply with curtailment orders pursuant to the new market rules and still purchase available power from Warren. This can occur because CMP may schedule the Warren facility and bid it into the pool with necessary adjustments to ensure the likelihood that the facility will not be backed down.

IV. DISCUSSION

We decline Warren's request that CMP be directed to enter a STEO agreement that does contain the provisions related to the new market rules. By insisting on the inclusion of these provisions, CMP is acting reasonably and consistent with State law and regulations.

The essence of Warren's argument is that it has an absolute right under State law to sell its excess energy to CMP whenever it is available. This is clearly not the case. Although the language in statute and rules explicitly requires utilities to purchase available QF power, this requirement has never been considered absolute. Chapter 360 of our rules has always recognized the right of utilities to curtail QF purchases at times of system emergencies (Chapter 360, § 6), as well as at times when, due to operational circumstances, purchases would result in "negative avoided costs (Chapter 360, § 4(D)). The question therefore becomes whether it is reasonable and consistent with State law and policies for CMP, as a result of new market rules, to insist on the contractual right to curtail its purchases from Warren when directed to by ISO-NE or be compensated for the costs of not doing so.

We find that section 4(D) of Chapter 360, which allows utilities to curtail QF purchases when such purchases would result in negative avoided costs, is applicable to the current circumstances. Section 4(D) states:

> D. Periods During Which Purchases Are Not Required
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> 1. Any electric or transmission and distribution utility which gives notice pursuant to paragraph 2 of this subsection will not be required to purchase electric energy or capacity during any period during which, due to operational circumstances, purchases from qualifying facilities can reasonably be expected to result in negative avoided costs.
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> 2. Any electric or transmission and distribution utility seeking to invoke paragraph 1 of this subsection must notify the Commission and each affected qualifying facility at least 48 hours prior to period described above. Such notice shall include a description of the operational circumstances, and the duration of the period.
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> 3. Any electric or transmission and distribution utility which fails to comply with the provisions of paragraph 2 of this subsection or which unreasonably invokes the provisions of this subsection will be required to pay the same rate for such purchase of energy or capacity as would be required had the period described in paragraph 1 of this subsection not occurred.

In our Order adopting this provision, we explained that the purpose of this provision is to prevent a circumstance in which a utility would incur negative avoided costs (i.e., positive costs) by virtue of purchasing QF power (rather than saving or avoiding energy or capacity costs as would normally occur). Decision and Order Adopting Rule (Chapter 36 Cogeneration and Small Power Production), Docket No. 80-268 at 23 - 35 (May 7, 1981). As an example of such a circumstance, we described a period when the utility's load is so low that it would be required to shut down a large nuclear station; because of its operating characteristics, once shut down, it will take a long time to return the facility to service. We stated that, under such circumstances, a utility may terminate QF purchases if doing so would avoid the shutdown of the plant.

The "light load" circumstance described in our 1981 Order is analogous to the circumstances at issue in this case where ISO-NE directs a "self-scheduled" unit to be backed down due to transmission constraints, excess generation on the system, or other reliability constraints. By making "negative" bids and paying back down charges (or subjecting itself to sanctions, for not complying with ISO-NE dispatch orders), CMP would incur a positive cost (or a negative avoided cost) as a result of purchasing QF power; the precise result section 4(D) intended to avoid. Because the required back down of the self-scheduled unit results from a system constraint, it constitutes an "operational circumstance" as contemplated in our rule.

However, section 4(D) would not apply light load or other system constraint situations if the associated costs to utilities are reasonably incorporated in the avoided cost calculations upon which QF rates are determined. In such a case, there would be no uncompensated utility costs and, thus, no negative avoided costs. FERC, in adopting rules corresponding to that of section 4(D) (18 C.F.R. § 292.304(f)), also cited light load situations and baseload plant operational characteristics as a circumstance in which utilities are not required to purchase from QFs, but suggested the provision would not apply if light load circumstances and their associated costs are taken into account in establishing rates for QF purchases. 45 Fed. Reg. 12214 at 12227-28 (Feb. 25, 1980). Thus, section 4(D) can be viewed as a provision to protect utilities (and their ratepayers) from incurring positive costs that are not reasonably incorporated into avoided cost calculations.

Viewed in this light, a conceptually correct resolution of the current dispute would be to incorporate reasonable projections of the costs of back down charges necessary for CMP to accept all of Warren's excess energy in the calculation of STEO rates. However, because New England's electricity markets will be operating under completely new rules beginning May 1, there is no reasonable means to project and incorporate such costs into avoided cost calculations. These costs would depend on the amount of self-scheduled generation in the region, and the amount and level of negative bids; they cannot be determined in the absence of market experience.[4]

Under these circumstances in which, due to operational constraints, certain costs or negative avoided costs associated with purchasing QF power cannot reasonably be incorporated in avoided cost calculations, section 4(D) applies to prevent economic loss to utilities and ratepayers.[5] Allowing such an economic loss to incur would be inconsistent with the basic concept of basing QF rates on utility avoided costs, which is to keep utilities economically neutral to purchases of power from QFs.

Even if section 4(D) did not directly apply to the current circumstances, our resolution of this dispute would not change. Chapter 360 has always contemplated that the specific rates, terms and conditions of utility/QF contracts would be subject to good faith negotiations. Chapter 360 was never intended to establish all contractual terms and conditions governing the utility and QF relationship. Accordingly, under section 7 of the Rule, either party may petition the Commission to establish a disputed contractual rate, term, or condition. In our recent rulemaking on this Chapter (Docket No. 97-794), we added language (consistent with section 8 of the Restructuring Act) that recognizes the reality of major industry changes, by specifying that section 7 applies to contract provisions "rendered impractical or impossible" due to industry restructuring. It is the Commission's responsibility to resolve disputes under section 7 consistent with the policies incorporated in statute and Chapter 360. As mentioned above, requiring CMP to enter the Warren contract without the new market rules provisions would be contrary to the economic neutrality embodied in the fundamental concept that purchases of QF power will be at the utility's avoided cost.

Having denied Warren's request to direct CMP to enter the STEO agreement without the disputed provisions, we state our expectation that CMP will work with Warren (as it has stated its willingness to do) to determine the level of negative bids and back down charges that Warren is willing to pay to avoid disruption of operations at its facility.[6]

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[4]After the New England markets have operated for several months, we may consider re-establishing STEO rates to incorporate projections of negative clearing prices. If we do so, it may be appropriate to establish two sets of STEO rates: one for QFs that are willing to curtail (in which case, there would be no negative clearing prices reflected); and the other for QFs that do not want to be curtailed. In their STEO contract, CMP and Warren could allow for the possibility that the Commission may modify STEO rates in this regard.

[5]Section 4(D) requires utilities to provide at least 48 hours notice prior to the curtailment period. During the technical conference, CMP indicated that it would not have 48 hours notice of a back down order from ISO-NE. If necessary, CMP can seek a waiver of the notice provision by showing good cause.

[6]CMP should also be willing to negotiate any mutually agreeable arrangement with Warren, such as reconciling payments after the fact based on actual market

Because we have concluded that, under State law and regulations, CMP is not required to purchase Warren's excess energy when presented with an ISO-NE back down order, we need not address the federal preemption and filed-rate doctrine arguments. However, we note our disagreement with Warren's suggestions that the region's market rules are being developed in insolation by NEPOOL utilities which are free to disregard other interests. As pointed out by CMP, NEPOOL now includes all market participants, and FERC has overseen the steps NEPOOL and ISO-NE have taken to establish the market rules. Thus, Warren and similarly situated QFs have several forums to express their views and protect their interests.

Finally, we note our general agreement with Warren that the problem of QF "must run" status created by changes in market rules goes beyond Warren and impacts all of CMP's (as well as other NEPOOL participant) QF contractual relationships. However, this is not a reason for us to resolve the dispute before us in a manner that would be inconsistent with State policies and rules. Contrary to its arguments, Warren is in a different position than other QFs in that it is negotiating a new contract, and CMP would not be acting reasonably if it were to execute a contract that ignores the new market rules and their economic consequences. Additionally, CMP has represented that, pursuant to the new market rules, it is required to include the disputed provisions in all new contracts, and that sanctions will be waived (although back down charges will still apply), if CMP fails to comply with an order with respect to existing contracts. In this proceeding, we resolve only the dispute before us. CMP remains free to pursue any course respecting existing QF contractual relationships that it considers appropriate.

Dated at Augusta, Maine, this 29th day of April, 1999.

BY ORDER OF THE COMMISSION

Raymond Robichaud
Assistant Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Diamond

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of

clearing prices.

review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Civil Procedure, Rule 73, et seq.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.